Previously we discussed problems with the T&M (and Labor Hour) contract type at the Prime Contract level. In this article, we want to discuss problems at the subcontract level—*i.e., why in the world would you ever issue a T&M type subcontract?*

Well, we know one answer to that semi-rhetorical question. You issue a T&M subcontract when you have a T&M prime contract, and you need separate subcontractor billing rates. Prior to 2007, prime contractors could plausibly argue that, if a subcontractor was performing the same work as the prime contractor, the subcontractor's labor hours could be billed at the same fixed hourly rates as the prime contractor. (There was even a somewhat-on-point legal precedent that stood for the proposition that it was the work that counted, and not who performed it.) But in 2007, everything changed. Federal Acquisition Circular 2005-15 and DFARS Change Notice 2006-1212 amended the regulations applicable to T&M (and Labor Hour) type contracts in several areas, and thus most contracts subsequently were required to have three sets of billing rates: (1) for the prime's employees, (2) for each subcontractor's employees, and (3) for any work performed by a subsidiary or separate division of the prime contractor. (Note that competitively awarded non-DOD contracts are subject to different, more lenient, requirements.) Subcontractor efforts that don't qualify as required labor hour work (*i.e.*, subcontract efforts that don't constitute delivered labor hours) cannot be billed under the "T" portion of the contract, and must be billed under the "M" portion at actual costs paid (plus applicable indirect costs, less fee).

So if you have a T&M contract that requires separate billing rates, you would want to put your subcontractor under a T&M contract. If you didn't, then you would have to bill the subcontractor's efforts at actual costs with no profit component. So that's one answer to the question we posed; but now we are running out of answers.

If you intend to award a T&M subcontract, you are entering into a world of hurt. First, you may be dealing with a small business entity that may not have an "adequate" accounting system, as defined by the SF 1408 or DCAA. That's fine from a technical standpoint—there is no requirement in the FAR or DFARS that T&M contractors must have an "adequate" accounting system, as there is for cost-reimbursement contractors. But the problem there (as we saw in Part 2) is that too many Government people think that a T&M contract is "flexibly priced"—and hence cost-reimbursement—and so an "adequate" accounting system must be required to be in place before contract award. They're wrong, of course. But setting them straight will be a challenge.

Similarly, there is no requirement to find that "no other contract type is suitable" with respect to entering into a subcontract; yet Contracting Officers may think that the requirement should apply to a prime's subcontracting. If the prime contractor is submitting a proposed T&M subcontract package for consent, it may prove problematic to convince the CO that consent should be given, absent such a document in the file.

If you enter into a T&M subcontract, and the subcontractor applies indirect costs to the reimbursable "M" portion of the subcontract, then the requirements of the Allowable Cost & Payment clause (52.216-7) apply. That clause requires, among other things, that the parties need to establish a reasonable provisional billing rate, which will be finalized after the subcontractor (a) submits its annual final indirect cost rate proposal, (b) that proposal is audited by a government audit agency, and (c) the rates are negotiated and finalized. That's going to take years—and your subcontract will remain open during that timeframe.

We should also note that the billed labor hours under the "T" part of the subcontract are to be billed in accordance with the T&M Payment clause 52.232-7. This will require (among other things) that the subcontractor must submit documents supporting its monthly billing, including individual daily job timekeeping records and records that substantiate the employee's billing rate category qualifications. That's going to be a bit burdensome, especially if your subcontractor is a small business that lacks a sophisticated timekeeping system. (We see no regulatory reason that "individual daily job timekeeping records" can't consist of several 3x5 cards, but still.)

Is there any way around these bureaucratic and burdensome billing requirements?

Well for one thing you can think about using quick-closeout rates if the subcontract qualifies. Revisions made to the FAR in June 2011 made it much more difficult to use quick-closeout procedures, but smaller value subcontracts may still qualify. (*See* FAR 42.708.)

Another possible approach may be to avoid the protracted indirect cost rate settlement issue by agreeing, upfront, to a firm, fixed-price for allocated indirect rates. That creates a risk for the contracting parties: if the actual (audited) rates are lower than the rates used to negotiate the FFP value, then the subcontractor will earn additional margin; but if the actual (audited) rates are higher, then the subcontractor will experience margin erosion. (Creating a FP-EPA or FP with reopener clause defeats the purpose, since the parties will still have to wait for the indirect rates to be audited and finalized.) And, in any case, the "M" portion of the contract will still be

based on actual costs incurred, so those costs will need to be audited and finalized as part of contract close-out activities (if for no other reason).

What if you negotiate an FFP price for both the (otherwise reimbursable) "M" portion, as well as any indirect costs allocated to that portion? Will that avoid the flexible price issue? Well, yes. And in that case, you can probably throw-out all requirements associated with the 52.216-7 clause, as well. But you might notice that the contract you have ended up negotiating looks very much like a FFP (or perhaps FFP-LOE) contract type, where everything is firm, fixed-price and the only variable is the actual number of labor hours delivered by the subcontractor. At that point, maybe you might want to consider moving toward an honest-to-goodness FFP (or FFP-LOE) contract, and in that manner simply avoid all the hassle and problems associated with the T&M subcontract?